

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Area Counsel
(Large Business & International)
Manhattan
from: William A. Jackson
Chief, Branch 05
(Income Tax & Accounting)

subject: Alternative Tax Net Operating Loss Deduction and Charitable Contribution Deduction

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Taxpayer = .

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Year 6 =

ISSUE

Whether a corporate taxpayer's charitable contribution deduction may reduce the amount of alternative tax net operating loss absorbed in a carryover year.

CONCLUSION

A corporate taxpayer's charitable contribution deduction may reduce the amount of alternative tax net operating loss absorbed in a carryover year.

FACTS

Taxpayer has substantial alternative minimum tax net operating loss (ATNOL) carryovers from Year 1, Year 2, and Year 3. Prior to taking any ATNOL or charitable contribution deduction into account, Taxpayer has alternative minimum taxable income (AMTI) of \$ and \$ respectively for Year 4 and Year 5. Taxpayer's total ATNOL carryover from Years 1 through Year 3 would be large enough to eliminate Taxpayer's positive AMTI for Year 4 and Year 5 if such deductions were not subject to the 90% limit of section 56(d)(1)(A).

Taxpayer also incurred an ATNOL for Year 6 of \$ for which Taxpayer made a valid section 172(b)(1)(H) election. Taxpayer had \$ of charitable contributions available for use in Year 4. Taxpayer also made \$ of charitable contributions in Year 5.

LAW AND ANALYSIS

Background

The issue presented is whether Taxpayer is entitled to take charitable contribution deductions into account in determining the amount of ATNOL absorbed in Year 5. Examination contends that Taxpayer cannot take such deductions into account. As the following discussion indicates, we conclude that charitable contribution deductions are taken into account in determining the amount of ATNOL absorbed in Year 5. However, as outlined below, such deductions also affect the amount of ATNOL absorbed in Year 4.

Section 172(a) allows a deduction equal to the aggregate of a taxpayer's net operating loss (NOL) carryovers and carrybacks to the taxable year. An NOL is defined as the excess of allowable deductions over gross income, with specified modifications. I.R.C. §§ 172(c) and (d). The section 172(d) modifications, among other things, disallow any section 199 deduction in computing an NOL.

Section 56(a)(4) requires that AMTI be computed by deducting the taxpayer's ATNOL rather than the taxpayer's NOL. Section 56(d)(2)(A) generally requires a taxpayer to compute its ATNOL in the same manner as it computes its NOL. However, in computing an ATNOL the taxpayer is required to take into account tax adjustments, as defined in section 56 and section 58, and tax preferences, as defined in section 57.

In contrast to the NOL, which is not subject to any percentage limitations, section 56(d)(1)(A) limits the amount of ATNOL that may be deducted to the lesser of the ATNOL or

POSTF-122880-11

90 percent of AMTI determined without regard to the ATNOL deduction or the section 199 deduction (the 90% limit).

Section §13 of the Worker, Homeownership, and Business Assistance Act of 2009, Pub. L. No. 111-92, 123 Stat. 2984 (November 6, 2009) (the WHBAA) amended section 172 (b) (1) (H) to allow taxpayers to elect to carry back an applicable NOL for a period of 3, 4, or 5 taxable years. Section 172 (b) (1) (H) (ii) provides that the term “applicable NOL” means the taxpayer's NOL for a taxable year ending after December 31, 2007, and beginning before January 1, 2010.

The WHBAA also removed the 90% limit for any ATNOL for which a taxpayer makes a section 172(b)(1)(H) election. The WHBAA did this by allowing ATNOL deductions for such an ATNOL in excess of the amount of the ATNOL deduction subject to the 90% limit as specified in section 56(d)(1)(A)(ii)

Section 170(a) allows a deduction for any charitable contribution (as defined in section 170(c)) payment of which is made within the taxable year. Section 170(a)(2) allows accrual method corporate taxpayers to elect to treat a charitable contribution as paid during the taxable year if (1) the corporation's board of directors authorizes a charitable contribution during the taxable year, and (2) payment of such contribution is made after the close of such taxable year and on or before the 15th day of the third month following the close of such taxable year.

Section 170(b)(2) generally limits the amount of a corporations charitable contribution deduction to no more than 10 percent of the corporation's taxable income (the 10 percent limit). For this purpose taxable income is computed without regard to (1) the charitable contribution deduction, (2) part VIII (except section 248), (3) any NOL carryback to the taxable year, (4) section 199, and (5) any capital loss carryback to the taxable year under section 1212(a)(1).

Section 170(d)(2) provides for a carryover for charitable contributions a corporation makes in a taxable year that exceed the 10 percent limit. In determining which charitable contributions are deductible in a taxable year, current year contributions take priority over carryover contributions. If current year contributions are less than the 10 percent limit, carryover contributions are taken into account in the order in which they arose. The carryover period for charitable contributions is limited to 5 taxable years.

Pursuant to section 172(b)(2) and the regulations thereunder, the amount of an NOL that is absorbed in a carryover or carryback year equals taxable income for that year determined with certain modifications (modified taxable income). Modified taxable income is determined without taking into account the NOL for which the absorption calculation is being made (the NOL to be absorbed). Modified taxable income is also generally determined without taking into account any NOLs that arise in taxable years after the taxable year of the NOL to be absorbed. In determining modified taxable income deductions that are limited to a percentage of taxable income are recomputed without taking the NOLs referred to above into account. Treas. Reg. §1.172-5(a)(2)(ii).

POSTF-122880-11

Although the 10 percent limit on a corporation's charitable contribution deduction is determined without regard to NOL carrybacks, NOL carryovers are taken into account in determining that limitation. For example, if an NOL carryover eliminates a taxpayer's taxable income, no charitable contribution deduction is allowable. However, modified taxable income is computed without deducting the NOL carryover to be absorbed. This means that more charitable contribution deductions may be allowable in computing modified taxable income than are allowable in computing taxable income. By reducing modified taxable income these additional charitable contribution deductions may result in less NOL being absorbed than the actual amount of NOL used to reduce positive taxable income. Thus, the additional charitable contribution deductions allowed in determining modified taxable income may increase the amount of NOL carryover to a subsequent taxable year thereby "freeing up" some of the NOL for future use.

The additional charitable contribution deductions allowed in computing modified taxable income are not deducted in computing taxable income. If these additional deductions are allowed as charitable contribution carryovers, the deductions may produce a double tax benefit first by reducing the amount of NOL carryover absorbed, and second by also reducing taxable income in a subsequent taxable year as a charitable contribution deduction.

Section 170(d)(2) prevents this double tax benefit by reducing the taxpayer's charitable contribution carryover in certain circumstances. This reduction occurs to the extent the additional charitable contribution deductions allowed in computing modified taxable income also increase the amount of an NOL carryover.

The above rules also apply separately to the absorption of ATNOLs. In addition, section 56(d)(1)(B)(ii) provides that in determining the amount of ATNOL absorbed in a taxable year, appropriate adjustments shall be made to take into account the 90 percent limit. In most circumstances this means that the ATNOL will be absorbed by 90 percent of modified AMTI rather than 100 percent of modified AMTI.

Simultaneous Equations

Taxpayer has a large ATNOL carryover to Year 4 which, if not subject to the 90 percent limit, would be large enough to eliminate all of Taxpayer's positive AMTI for that year. Taxpayer also has a total of \$ _____ of charitable contributions available for use in Year 4.

The statutory language that imposes the 90 percent limit on the ATNOL deduction does not exclude the charitable contribution deduction from the measure of income on which the limitation is computed. Likewise, the statutory language that imposes the 10 percent limit on the charitable contribution deduction does not exclude any ATNOL deduction attributable to an ATNOL carryover from the measure of income on which that limitation is computed. Therefore, Taxpayer's 90 percent limit on its ATNOL deduction must be computed on a measure of income that includes the charitable contribution deduction, and Taxpayer's 10 percent limit on its charitable contribution deduction must be computed on a measure of income that includes the ATNOL carryover deduction.

POSTF-122880-11

In your request for advice, you note that in the absence of a statutory ordering rule that specifies which deduction takes priority simultaneous linear equations have been used. See *Shell Oil Company v. Commissioner*, 89 T.C. 371, 419-420 (1987) *rev'd. in part and remanded in part*, 952 F.2d 885 (5th Cir. 1992); Rev. Rul. 79-347, 1979-2 C.B. 122. We agree that simultaneous linear equations may be used to determine the proper amount of each deduction.

The interrelationship of the 10 percent charitable contribution deduction limit and the 90 percent ATNOL deduction limit can be expressed in the following two linear equations:

$$\begin{aligned}x &= .1 (G - y) \text{ and} \\y &= .9(G - x)\end{aligned}$$

where G represents AMTI determined without regard to either deduction, x represents the theoretical charitable contribution deduction limitation, and y represents the theoretical ATNOL deduction limitation.

Using algebra, the equations can be solved as follows:

(1) Solving for x:

$$\begin{aligned}x &= .1 (G - y) \\x &= .1(G - .9(G - x)) \\x &= .1(G - .9G + .9x) \\x &= .1G - .09G + .09x \\\therefore .91x &= .01G\end{aligned}$$

hence $x = .010989010989011G$

(2) Solving for y:

$$\begin{aligned}y &= .9(G - x) \\y &= .9(G - .1(G - y)) \\y &= .9(G - .1G + .1y) \\y &= .9G - .09G + .09y \\\therefore .91y &= .81G \\\text{hence } y &= .89010989010989G\end{aligned}$$

POSTF-122880-11

As noted in Rev. Rul. 79-347, if the theoretical limit on a deduction exceeds the actual amount of that deduction available, only the actual amount of the deduction available is allowable, and the limitation on the other deduction is computed using that amount.

Computations

Taxpayer's Year 4 and Year 5 AMTI taking into account the ATNOL carryovers and charitable contributions available for use in those years is computed below. We have also computed the amount of ATNOL and charitable contribution deductions absorbed in those years.

	Year 4	Year 5
AMTI Before Anything ATNOLD @89.010989010989%	\$	\$
CCD @10% AMTI	\$	\$
Percentage Check 90% AMTI		
AMTI Before Anything CCD AMTI Before ATNOL	\$	\$
	0.90	0.90
	\$	\$
Absorption		
AMTI Before Anything CCD Modified AMTI 90% Modified AMTI	\$	\$
	\$	\$

POSTF-122880-11

ATNOL Freed-up

90% Modified AMTI	\$	\$
ATNOL Deducted		
Difference--ATNOL Freed-up (1)		

CCD Used to Reduce Modified AMTI	\$	\$
Actual CCD Deduction		
Difference (2)	\$	\$

CCD Absorbed
 CCD Deducted
 CCD Deducted in Computing Modified AMTI that Freed-up ATNOL-Lesser of (1) or (2)

CCD Absorbed	\$	\$
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CCD Available		
CC Carryover to Succeeding Year	\$	\$

Year 5 Contribution		
Total Available for Year 5	\$	

Analysis of the above numbers shows that the total amount of ATNOL and charitable contribution deductions absorbed equals the total amount of such deductions allowable in computing AMTI. However, less ATNOL is absorbed than is deductible in computing AMTI and more charitable contributions deductions are absorbed than are deductible in computing AMTI.

Taxpayer also incurred an ATNOL for Year 6 of \$ for which Taxpayer made a valid section 172(b)(1)(H) election. This ATNOL is carried back to Year 4 and Year 5 subject to the limitations of section 56(d)(1)(A)(ii).

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

POSTF-122880-11

Please call 202-622-4960 if you have further questions.

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